



AASHTO Peer Review of the  
Alabama Department of Transportation  
Bureau of Finance and Audits – External and Internal Audit Sections

Review Period from October 1, 2005 through September 30, 2006

Peer Review Team Members

W. Wayne Rogers, North Carolina DOT, Team Leader  
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**AASHTO Audit Peer Review**  
**Alabama Department of Transportation**  
**Bureau of Finance & Audits – External and Internal Audit Sections**

October 26, 2006

Mr. Lamar McDavid, Director of Finance & Audits  
Alabama Department of Transportation  
1409 Coliseum Blvd.  
Montgomery, Alabama 36130-3050

## Objective

The primary objective was to perform a peer review of the quality control system in effect for the Alabama Department of Transportation, Bureau of Finance & Audits – External and Internal Audit Sections for the period October 1, 2005 through September 30, 2006. Our review was conducted in conformity with the Peer Review Bylaws and other guidelines of the American Association of State Highway and Transportation Officials Standing Committee on Administration, Administrative Subcommittee on Internal and External Audit, along with those set forth under the General Accounting Office's Government Auditing Standards (2003 Revision).

## Scope

The scope of the review included:

- Questionnaires completed by the Department Head, Audit Director, Internal and External Audit Management and Staff and audit report users.
- An auditee survey was sent to management officials who had been audited during the review period, which solicited their responses concerning scope, nature, and quality of auditing.
- Interviews, as necessary, were held with members of the senior management of the Alabama Department of Transportation – External and Internal Audit Sections.
- A review of audit area's internal control system and the quality control policies, procedures, practices, and information used for managing the audit group.
- An examination of a sample of audit, review and/or examination files completed during the review period sufficient to provide a reasonable basis to render an opinion as to whether policies and procedures were being complied with to provide the Alabama Department of Transportation, Bureau of Finance & Audits – Internal and External Audit Sections with reasonable assurance of conforming with professional standards in the conduct of their work.
- Fieldwork conducted at the Alabama Department of Transportation from October 23, 2006 through October 26, 2006.

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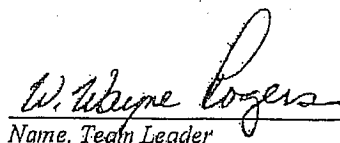
## Opinion


Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

Our review disclosed that the Alabama Department of Transportation, Bureau of Finance & Audits – Internal Audit Section's organizational independence is impaired. This matter is discussed in more detail in our letter of comments dated October 26, 2006.

Based on our review, it is the opinion of the Peer Review Team that the Alabama Department of Transportation, Bureau of Finance & Audits – External and Internal Audit Sections, except for the deficiency described in the preceding paragraph, complies with the Peer Review Bylaws and other guidelines of the American Association of State Highway and Transportation Officials Standing Committee on Administration, Administrative Subcommittee on Internal and External Audit and those of the General Accounting Office's Government Auditing Standards (2003 Revision).

Other than the deficiency noted above, the expressed opinion implies that the internal quality control system found within this area was adequate and the quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming with the applicable professional standards.

  
Name, Team Leader

  
Name, For the Peer Review Panel



October 26, 2006

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### **Letter of Comments**

This letter contains our observations as they relate to the Standards subscribed to by the Alabama Department of Transportation, Bureau of Finance & Audits – External and Internal Audit Sections. We identify the condition observed and make a recommendation for improvement that would also ensure full compliance with the Standards.

#### **Matter that Resulted in a Modified Opinion**

The Internal Audit Manager of the Bureau of Finance & Audits reports directly to the Director of the Bureau of Finance & Audits who manages the Alabama Department of Transportation's accounting function. This reporting relationship creates the appearance that the Internal Audit Section conducts audits of functions for which the Director of the Bureau of Finance & Audits has responsibility, thus impeding or compromising internal audit independence. The External Audit Manager of the Bureau of Finance & Audits maintains organizational independence by reporting directly to the Director of the Bureau of Finance & Audits who does not manage functions subject to external audit.

According to the general standard related to independence (Section 3.03), in all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free both in fact and in appearance from personal, external, and organizational impairments to independence. The general standard (Section 3.05) also provides that, in the event that the audit organization's and/or the individual auditor's independence is impaired, and it is not possible to decline to perform the work, the impairment or impairments should be documented in the scope section of the audit report.

According to the general standard related to personal impairments (Section 3.07), the audit organization should have an internal quality control system to help determine whether auditors have any personal impairments to independence that could affect their impartiality or the appearance of impartiality. An example of a personal impairment is responsibility for managing an entity or decision making that could affect operations of the entity or program being audited. The Director of the Bureau of Finance & Audits is responsible for managing an entity or program potentially subject to internal audit.

According to the general standard relating to organization impairment (Section 3.27), a government internal audit organization can be presumed to be free from organizational impairments to independence

when reporting internally to management if the head of the audit organization meets all of the following criteria:

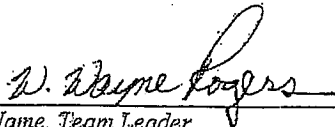
- a. is accountable to the head or deputy head of the government entity,
- b. is required to report the results of the audit organization's work to the head or deputy head of the government entity, and
- c. is located organizationally outside the staff or line management function of the unit under audit.

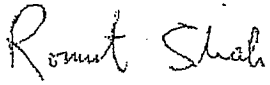
The Internal Audit Section meets the first two criteria (a. and b.), but does not meet the third criteria (c.) since it could potentially audit functions performed by the Bureau of Finance & Audits.

According to the general standard relating to organizational impairment (Section 3.32), the audit organization should document the conditions that allow it to be considered free of organizational impairments to independence to report internally. We were not provided with documentation to substantiate management's belief that the Internal Audit Section is organizationally independent.

### **Recommendation**

The Internal Audit Section of the Bureau of Finance & Audits should strive to seek independence. If the Alabama Department of Transportation, Bureau of Finance & Audits does not restructure organizationally, the Internal Audit Section should disclose the organizational independence impairment in the scope paragraph of the audit report.

  
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Name, Team Leader

  
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Name, For the Peer Review Panel